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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1870

E. I. DU PONT DE NEMOURS AND COMPANY
and CHRISTIANA SECURITIES COMPANY,
Petitioners,

v.

RICHARD J. COLLINS, JR., LEWIS C. MURTAUGH,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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TABLE OF CONTENTS

	Page
OPINION BELOW	2
JURISDICTION	2
QUESTION PRESENTED	2
STATUTE INVOLVED	2
STATEMENT OF THE CASE	4
REASONS FOR GRANTING THE WRIT	8
I. The Court of Appeals erred in rejecting the Commission's determination that the net asset value of an investment company, rather than the market value of its stock, should be the basis for merger terms	9
II. The Court of Appeals exceeded its review authority in requiring that any tax savings by Christiana or its stockholders be shared with Du Pont	14
III. The Court of Appeals departed from the accepted and usual course of appellate procedure	17
CONCLUSION	18
APPENDIX	1a

TABLE OF AUTHORITIES

Camp v. *Pitts*, 411 U.S. 138 (1973) 17

Federal Power Commission v. *Transcontinental Gas Pipe Line Corp.*, —— U.S. ——, 44 U.S.L.W. 3413 (U.S. Jan. 19, 1976) 17-18

Harriman, et al. v. *E. I. du Pont de Nemours and Co., et al.*, Civil Action No. 4721 (D. Del. Dec. 23, 1975) (CCH FED. SEC. L. REP. ¶ 95,386) 8

La Buy v. *Howes Leather Co.*, 352 U.S. 249 (1957) .. 17

Niagara Hudson Power Corp. v. *Leventritt*, 340 U.S. 336 (1951) 8, 12, 13

Page

Securities and Exchange Commission v. *Chenery Corp.*,
332 U.S. 194 (1947) 8, 10, 11

STATUTES AND RULES

Investment Company Act of 1940
15 U.S.C. § 80a-2(a)(41) 9-10
15 U.S.C. § 80a-17 ..... 2, 5
15 U.S.C. § 80a-42 ..... 7, 17
15 U.S.C. § 80a-43 ..... 2, 3

Public Utility Holding Company Act
15 U.S.C. § 79k 12

Securities Exchange Act of 1934
15 U.S.C. § 78j(b) 8

Treasury Regulation, § 20.2031-1(b) 12

28 U.S.C. § 1254(1) 2

28 U.S.C. § 2111a(a) 6

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Petitioners E. I. du Pont de Nemours and Company ("Du Pont") and Christiana Securities Company ("Christiana") pray that a writ of certiorari issue to review a judgment and opinion of the United States Court of Appeals for the Eighth Circuit reversing a determination by the Securities and Exchange Commission ("Commission") under the Investment Company Act of 1940 that the terms of a proposed merger between Christiana and Du Pont are fair and reasonable.

OPINION BELOW

The opinion and order of the Commission, the majority and dissenting opinions of the Court of Appeals, and the order of the Court of Appeals denying, by an equally divided vote, petitions for rehearing and suggestions for rehearing in banc are set out in the Appendix to the petition for a writ of certiorari that has been filed this day by the Securities and Exchange Commission ("SEC Petition").

JURISDICTION

The judgment of the Court of Appeals was entered on January 23, 1976. On February 26, 1976, the Court of Appeals denied timely motions for rehearing. On May 15, 1976, the Commission and the Petitioners were granted, in an order by Mr. Justice Blackmun, an extension of time to file petitions for writs of certiorari until June 25, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTION PRESENTED

Whether, in setting aside the determination of the Commission that the terms on which Du Pont and Christiana propose to merge are fair and reasonable and involve no overreaching, and thus meet the standard of Section 17 of the Investment Company Act, the Court of Appeals was warranted in substituting its own views for the judgments of the Commission on securities valuation, fairness, overreaching and protection of investors.

STATUTE INVOLVED

Sections 17 and 43 of the Investment Company Act, 15 U.S.C. § 80a-17, 42, provide in pertinent part:

§ 17 (a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 80a-12(d)(3)(A) and (B) of this title), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal—

> (1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company, . . .

(b) Notwithstanding subsection (a) of this section, any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of said subsection. The Commission shall grant such application and issue such order of exemption if evidence establishes that—

> (1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned;
>
> (2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this subchapter; and
>
> (3) the proposed transaction is consistent with the general purposes of this subchapter.

§ 43 (a) Any person or party aggrieved by an order issued by the Commission under this subchapter may obtain a review of such order in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty

days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * * Upon the filing of such petition such court shall have the jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. * * *

STATEMENT OF THE CASE

This case arises out of a challenge by Respondents Murtaugh and Collins, stockholders of Du Pont, to an order of the Commission approving the terms of a proposed merger of Christiana, an investment company, into its affiliate, Du Pont. Certain transactions between investment companies and their affiliates, including mergers, which are viewed as a sale of property, are prohibited by the Investment Company Act unless the Commission finds that the proposed terms are fair and reasonable and do not involve overreaching on the part of any person concerned (15 U.S.C. § 80a-17).

Christiana owns approximately 28 percent of the outstanding Du Pont common stock. That holding, which had a market value of approximately $2 billion at the time the merger agreement was negotiated, represents over 98 percent of the total value of Christiana's assets.[1] The merger terms contemplate that Du Pont will retire all the Du Pont common stock presently held by Christiana and will issue for distribution to Christiana stockholders new Du Pont common stock. In substance, therefore, as the Commission recognized, the proposed merger involves an exchange of equivalents, Du Pont common stock for Du Pont common stock.

An application for approval of the merger terms under Section 17 of the Investment Company Act was filed with the Commission and notice of such application was sent by Christiana and Du Pont respectively to each of approximately 8,000 Christiana stockholders and 225,000 Du Pont stockholders. Five Du Pont stockholders requested a hearing which was subsequently held before an Administrative Law Judge and testimony was taken over a period of seven days.

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[1] The balance of Christiana's assets at that time consisted of cash, a 3 percent interest in the Wilmington Trust Company, all of the stock of a newspaper, The News-Journal Company, and a small holding of Du Pont preferred stock which in the aggregate had an adjusted value (net of current liabilities) of some $26 million.

By agreement the matter was presented directly to the Commission and following briefs and oral argument the Commission, by unanimous vote, found the terms of the proposed merger to be fair and reaable and to involve no overreaching. Two stockholders of Du Pont, Murtaugh and Collins, sought judicial review of the Commission order.[2] The Court of Appeals set aside the Commission's order on the ground that the merger terms were unfair to Du Pont despite the fact that Du Pont would issue somewhat fewer shares of its own common stock than it would receive from Christiana for retirement and would, in addition, receive some $26 million in miscellaneous assets.[3] The majority opinion was written by Circuit Judge Heaney and joined in by Senior District Judge Smith, Eastern District of Michigan, sitting by designation. Circuit Judge Stephenson filed a dissenting opinion. An equally divided court denied petitions for rehearing with suggestions for rehearing in banc filed by the Commission and by Du Pont and Christiana.

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[2] Section 43 of the Investment Company Act permits review by any Court of Appeals within whose jurisdiction a party resides. The Murtaugh petitions, originally filed in the Court of Appeals for the Seventh Circuit, were transferred to the Court of Appeals for the Eighth Circuit pursuant to 28 U.S.C. § 2111a(a) and consolidated with the Collins petition which had an earlier filing date.

[3] Du Pont would issue shares of its own common stock equal in value to 97.5 percent of the adjusted net asset value of all Christiana's assets. The resulting discount of 2.5 percent, representing a gain in equity and participation in earnings for non-Christiana shareholders of Du Pont, is larger than any discount previously approved by the Commission or found in any reported transaction. At the market value of Du Pont stock as of the date the merger terms were established, Du Pont would issue 188,500 fewer shares of common stock than it would receive from Christiana for retirement.

The Court of Appeals rejected the Commission's judgment in two principal respects. (1) It held that the Commission erred in finding that the merger terms should reflect the value of Christiana's assets, principally Du Pont common stock, rather than the market price of Christiana stock. (2) It also held, contrary to the Commission's view, that as a matter of law Du Pont should share in any tax "savings" to Christiana and its stockholders resulting from the elimination of the intercorporate dividend tax and the tax-free character of the proposed merger.

In its review of the Commission order, the Court of Appeals, after receiving briefs and hearing argument, employed Professor Roger B. Upson, Associate Dean of the University of Minnesota College of Business Administration, "to assist the Court in understanding the record in this case and to prepare reports and memoranda for this Court in connection with that function" (SEC Petition 91a, n.40). Aside from a report filed by Professor Upson on which the parties were accorded an opportunity for comment, it is not possible to assay his role in the Court's review of the Commision's decision. That report includes numerous data and observations that are not a matter of record, are not a proper subject of judicial notice and were, of course, at no time considered by the Commission which is charged by Congress with passing initially on all relevant evidence (15 U.S.C. § 80a-42).

One of the petitioners in the Court of Appeals, Murtaugh, brought a stockholder's derivative action claiming that the merger terms contravene Delaware state law and also constitute fraud and misrepresentation in violation of Section 10(b) of the Securities

Exchange Act of 1934, 15 U.S.C. §78j(b). Following a full evidentiary hearing, that challenge was rejected by the United States District Court for Delaware, *Harriman, et al.* v. *E. I. du Pont de Nemours and Co., et al.*, Civil Action No. 4721 (D. Del. Dec. 23, 1975) (CCH FED. SEC. L. REP. ¶95,386). In rejecting plaintiffs' state law and Section 10(b) contentions, the District Court took into account the Commission's determination under the Investment Company Act as shown in the excerpt from its opinion set forth in the Appendix.

REASONS FOR GRANTING THE WRIT

The Court of Appeals rejected the Commission's judgments on matters that are central to the administration not only of the Investment Company Act but of other federal regulatory measures in which valuation, fairness, overreaching and protection of investors are of critical significance. In substituting its own views for those of the Commission on these matters that are entrusted by Congress to the Commission's expertise, the Court of Appeals has decided an important federal question in a way that conflicts with applicable decisions of this Court in *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 209 (1947) and *Niagara Hudson Power Corp.* v. *Leventritt*, 340 U.S. 336 (1951). These cases establish that it is the Commission and not the reviewing court that has the responsibility for ascertaining fairness in regulated securities transactions.

In addition, the manner in which the Court of Appeals considered and disposed of this matter is such a departure from accepted appellate procedure as to warrant the exercise of this Court's power of supervision. The Court of Appeals received off-the-record ex parte evidentiary assistance from an expert whose views were never considered by the Commission. Its decision was reached by a split vote, determined by an out-of-circuit Senior District Judge, that clearly warranted the in banc reconsideration voted by half the members of the court.

I. The Court of Appeals Erred in Rejecting the Commission's Determination that the Net Asset Value of an Investment Company, Rather than the Market Value of its Stock, Should be the Basis for Merger Terms.

The Commission found that the Investment Company Act, the intention of Congress in passing that Act, and the Commission's own consistent interpretation of the Act establish that the value of an investment company's assets rather than the price at which its common stock sells must determine the terms on which it may merge into an operating affiliate. In reaching its conclusion, the Commission carefully examined the economic factors that affect a closed-end investment company such as Christiana, and the nature of the interests of investors which are to be given significant weight. The solid support that these considerations give to the Commission's ultimate judgment is fully developed in the Commission's opinion and will not be repeated here. (SEC Petition 1a).

The Court of Appeals refused to accept the Commission's understanding of its own previous decisions, its reading of the Investment Company Act, and its ultimate judgment that the merger terms should re-

flect net asset value.[4] Even if this issue is viewed as one of first impression, as the Court of Appeals viewed it, the choice between market price and net asset value in determining proper treatment for investment company stockholders is certainly the kind of judgment that the Commission is best qualified to make and that is, under principles established by this Court, entitled to the greatest weight by appellate courts. In *Chenery* II, this Court reversed a decision by a Court of Appeals that had substituted its judgment for that of the Commission in the application of the "fair and equitable" test in reorganizations, a criterion strikingly similar to that applied by the Commission in this case. In so doing, this Court articulated the standard of review that should have been applied by the Court of Appeals in this case, but was not:

> "The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight

[4] Net asset value, for purposes of an investment company under the Act means the market value of such publicly traded securities which the investment company holds and the fair market value of its other assets less its liabilities. Section 2(a)(41) of the Act, 15 U.S.C. § 80a-2(a)(41). The record before the Commission includes a table that sets forth the salient details on ten mergers considered most closely comparable to the proposed merger of Christiana into Du Pont, six of which had required and received approval by the Commission. In each of the transactions the exchange ratio reflected net asset value; in none of them was the market price of the investment company stock, which was ordinarily significantly less than net asset value, considered determinative.

In addition, the record shows that three independent investment banking firms retained to advise the parties were each of the view that the merger terms should reflect net asset value and each found the terms agreed upon and submitted to the Commission for approval to be fair and reasonable: Morgan Stanley & Co.; The First Boston Corporation; and Kidder, Peabody & Co. Incorporated.

> by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See *Republic Aviation Corp.* v. *Labor Board,* 324 U.S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb." *Securities and Exchange Commission* v. *Chenery Corp.,* 332 U.S. 194, 209 (1947).

In assessing the significance of the market price of Christiana stock, the Court of Appeals correctly recognized that merger terms must reflect the value given and the value received by the respective shareholder groups. Its error was in assuming that the market price of Christiana common stock was the appropriate measure of what the Christiana stockholder group was contributing to the merger (SEC Petition 86a). That market price reflects the underlying value of the assets owned by Christiana less, however, a significant discount attributable to the intercorporate dividend tax payable by Christiana, a large potential capital gains tax liability in the event Christiana's assets were sold or distributed in a taxable liquidation, and a thin trading market. But all these burdens disappear in the merger and do not impair in any way the value of the Du Pont stock owned by Christiana which will be surrendered for retirement. It is that block of stock, as the Commission recognized, that determines the value given in the merger by the Christiana stockholders. The market value of Christiana stock will be merely a matter of history, of no significance to Du Pont or its stockholders.[5]

[5] In relying on the Internal Revenue Code as a principal source

The Court of Appeals' insistence that the merger terms reflect the market value of Christiana stock is, moreover, plainly at odds with this Court's decision in *Niagara Hudson Power Corp.* v. *Leventritt,* 340 U.S. 336 (1951), cited by the Commission in its opinion. There, in approving a plan of reorganization of a public utility holding company as "fair and equitable" under Section 11 of the Public Utility Holding Company Act, 15 U.S.C. § 79k, the Commission determined that warrants were not entitled to participate in the reorganization, despite the fact that they had a market value, because they had no fundamental investment value. The warrant holders urged that the Commission was required to attach significance to the market value of the warrants. In rejecting this contention the Court said:

> "In determining the fairness and equity of compensation to be allowed holders of warrants, the Commission is not bound as a matter of law, any more than in the case of other securities, to limit itself precisely to the values which the market recognizes. *The informed judgment of the Commission, rather than that of the market, has been designated by the Act as the appropriate guide to fairness and equity within the meaning of the Act.*
>
> * * *
>
> "It is enough that the Commission, within its discretion, has given the warrants careful consideration and that under all the circumstances, including their market value, has found the plan to be fair and equitable within the meaning of § 11 of the Act." 340 U.S. at 346-47 (emphasis supplied).

for its conclusion that market value of Christiana stock should control the merger terms, the Court of Appeals improperly conceived the function of the Commission. The court cited a number of gift and estate tax cases in support of its conclusion. Those cases, however, involve a tax based on the "fair market value" of stock as of a particular date, which has been defined in the tax regulations as the amount that would be paid in cash by a willing buyer to a willing seller. (Treas. Reg. § 20.2031-1(b)). While determinations of fair market value for tax purposes are matters for the Commissioner of Internal Revenue, a determination of the fairness and reasonableness of a fundamental corporate realignment under Section 17 of the Act, where stock rather than cash is the medium of exchange on both sides of the transaction, is a matter for the Commission's informed judgment.

The Commission here exercised the same judgment as it did in *Niagara Hudson.* It carefully examined all the factors, including the market value of Christiana stock. It concluded that net asset value, rather than market value, was controlling. As the Commission observed, "investment companies are as a general rule media for long-term investment. That makes net asset value the touchstone" (SEC Petition 32a, n.57). That determination was clearly within the scope of the administrative discretion that the Congress intended the Commission, and not the courts, to exercise.

The Commission found that the termination of Christiana's existence, to be accomplished by the proposed merger, would serve the public interest and likened it to voluntary compliance with the policy of corporate simplification mandated by Congress for public utility holding companies (SEC Petition 20a, n.42).[6] The Court of Appeals in rejecting the Commis-

[6] When Du Pont and Christiana were before this Court in 1960 in connection with their holdings of General Motors stock the Department of Justice urged that the merger of Christiana into Du Pont would accomplish antitrust objectives (Brief for Respondent, No. 55, p.70).

sion's reasoned judgment would render such termination impossible, at least for the foreseeable future.

II. The Court of Appeals Exceeded Its Review Authority in Requiring that Any Tax Savings by Christiana or Its Shareholders be Shared with Du Pont.

The Commission recognized that the proposed merger would benefit the Christiana stockholders significantly more than it would the Du Pont shareholders. It noted, however, that the benefits to the Christiana stockholders would be at no cost or other detriment to Du Pont or its stockholders, that they resulted from the operation of the federal tax laws and stock market phenomena (SEC Petition 10a, 11a). To require Christiana stockholders to forfeit to Du Pont shareholders any significant portion of the intercorporate dividend tax that would not longer be payable by Christiana, or the capital gains tax that might have been payable by some stockholders had Christiana liquidated in a taxable transaction rather than merged, or the appreciation in quoted market value from holding Du Pont common stock directly rather than indirectly, would be to divest Christiana stockholders, as the Commission viewed the matter, of some part of the intrinsic value of their investment (SEC Petition 33a). The Court of Appeals, however, simply ignored the Commission's reasoned analysis and asserted, without citation and as a matter of law, that fairness requires that Du Pont share in the tax savings that result from its cooperation in making the merger possible (SEC Petition 86a, n.35).

The reasoning behind this concept of fairness is quite revealing and perhaps constitutes the principal

explanation of the Court's disagreement with the Commission. In the first place, the Court of Appeals used the term "Du Pont family" as the equivalent of "Christiana stockholders" and its entire consideration of the rights and equities of such stockholders, who number some 8000, was tainted by the special disabilities it found in the "Du Pont family." While acknowledging that the members of the "Du Pont family" are under no duty to maximize their tax liability, the Court of Appeals pointedly observed that the "Du Pont family" had for many years chosen

> "to retain the economic, political and social advantages that accompanies control of one of America's largest industrial enterprises." (SEC Petition 87a).

That choice and those advantages, nowhere further identified, substantially estopped Christiana, the Court of Appeals held, from complaining about the operation of the tax laws, and warranted—indeed required—a substantial exaction from the current stockholders of Christiana [7] because certain of their predecessors in interest—those that were members of the "Du Pont family"—failed to terminate Christiana's existence 35 to 50 years ago and elected, instead, to enjoy advantages, nowhere found to be illegal or improper.

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[7] While members of the "Du Pont family" continue to own significant amounts of Christiana stock, the number of stockholders alone, 8000, attests that Christiana is no longer a family enterprise. The Commission noted that the purchase of Christiana stock was a common way to make a long-term investment in Du Pont. Some 12 percent of the Christiana stock is held by charitable organizations.

A misunderstanding of the responsibility delegated by Congress to the Commission by the Investment Company Act appears also to have infected the Court of Appeals' decision. It read that Act as requiring the Commission to ascertain the terms that the parties would have arrived at in arm's length bargaining (SEC Petition 61a). Because the Commission looked to the fairness of the terms agreed upon and satisfied itself that there was no overreaching but did not project the terms that might have been arrived at in arm's length bargaining, the Court of Appeals concluded that the Commission had failed to give the proposed merger the "scrutiny . . . intended by Congress" (SEC Petition 61a). Nothing in the Act, however, or in its legislative history suggests that the Commission should conjecture as to the terms of merger that might have been arrived at in arm's length bargaining. Instead, in a transaction between an investment company and its affiliate, the informed judgment of the Commission as to what is fair, reasonable and involves no overreaching has been substituted by act of Congress for arm's length bargaining. The purpose of that substitution, as the Commission observed, is to make sure that neither party exploits a strategic bargaining advantage to the disadvantage of the other, a not infrequent consequence of arm's length bargaining (SEC Petition 8a).[8]

[8] The Court of Appeals found minor fault, almost as an afterthought and certainly not as an essential element of its opinion, with the Commission's assessment of the considerable body of evidence bearing on the likelihood that the merger would engender sales of Du Pont stock in such volume as to have an adverse effect on its market price. The Court agreed with the Commission's conclusion that the market for Du Pont stock is sufficiently broad and strong that it can readily absorb any increased sales that might be expected to flow from the merger without significant effect on price for any extended period of time (SEC Petition 90a, n.39). It held, however, that the Commission should have given some weight to the "occasional detriment" to Du Pont shareholders that might be caused by sales following the merger. The Commission's assessment of the evidence on which the Court of Appeals based this holding was that intrinsic investment values would ultimately determine stock market prices and that transitory fluctuations could not be the predicate for fairness findings under the Investment Company Act (SEC Petition 28a). It was, therefore, clear error for the Court of Appeals to reject the Commission's informed judgment on matters so elusive as short-term stock market behavior and the significance to be accorded such behavior in determining fairness of merger terms.

III. The Court of Appeals Departed From The Accepted and Usual Course of Appellate Procedure.

The procedure followed by the Court of Appeals in exercising review in this matter is an additional reason why a writ should be granted. Professor Upson's participation in the review of the Commission's decision was certainly a departure from accepted appellate procedure, particularly in light of the explicit statutory direction that if additional evidence is deemed necessary on review, the matter must be remanded for the Commission's receipt and consideration of such evidence. (15 U.S.C. § 80a-42). This Court has specifically warned against "abdication of the judicial function," *La Buy* v. *Howes Leather Co.*, 352 U.S. 249, 256 (1957), and has directed that "the focal point for judicial review should be the administrative record already in existence, not some new record initially made in the reviewing court." *Camp* v. *Pitts*, 411 U.S. 138, 142 (1973). And only recently a Court of Appeals has been criticized for going outside the record in reviewing the action of an independent administrative agency. *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*,

—— U.S. ——, 44 U.S.L.W. 3413, 3414 (U.S. Jan. 19, 1976).

While the matter of rehearing, particularly in banc, is ordinarily within the discretion of a Court of Appeals, it is difficult to discern a rational basis for the unwillingness of the Court below to review the issues on which two of its members differed so sharply. As matters stand, the judgment of one member of the Court of Appeals and a visiting Senior District Judge has been substituted for the reasoned decision of the Commission in a complex matter in which the Commission's action is entitled to the greatest amount of weight by appellate courts.

CONCLUSION

For the reasons stated in this Petition and in that filed by the Securities and Exchange Commission a writ of certiorari should be granted.

Respectfully Submitted,

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APPENDIX

APPENDIX

Excerpt from the Decision of the United States District Court for the District of Delaware in *Harriman, et al.* v. *E. I. du Pont de Nemours and Co., et al.*, Civil Action No. 4721 (CCH FED. SEC. L. REP. ¶95,386 at 98,940 — 98,942)

SCHWARTZ, *District Judge*

. . .

. . .

c) *Fairness Under the 1940 Act*

The Investment Company Act of 1940 is a comprehensive federal regulatory scheme designed to protect shareholders of investment companies from a variety of sharp practices that had become widespread during the 1930s. *See generally,* "Comment, The Investment Company Act of 1940," 50 *Yale L.J.* 440, 441-2 (1941); Note, "The Investment Company Act of 1950," 41 *Col.L.Rev.* 269 (1941); *Brown* v. *Bullock,* 194 F. Supp. 207 (S.D.N.Y. 1961). Congress concluded that state regulation of investment companies was "impossible," 15 U.S.C. § 80a-1(a), and instead created a pervasive regulatory program aimed at countering specific categories of abuse directed at shareholders of investment companies. *See* 15 U.S.C. § 80a-1(b). *Entel* v. *Allen,* 270 F. Supp. 60 (S.D.N.Y. 1967). Among the most egregious of these abuses was an almost institutionalized phenomenon of investment companies and their portfolios being managed in the interest of affiliates, brokerage concerns or dealer interests, as opposed to being operated for the benefit of their shareholders. *See* 15 U.S.C. § 80a-1(1) and (2); *Herpich* v. *Wallace, supra,* 430 F.2d at 801; *Entel* v. *Allen, supra,* at 65. *See also,* "Comment," *supra,* 50 *Yale L.J.* at 441-2. In order to remedy this particular practice, Congress decided to prohibit securi-

ties transactions between investment companies and affiliated persons [130] thereof, 15 U.S.C. § 80a-17(a), except where the SEC had granted an exemption on the grounds, *inter alia,* that the transaction is fair to all persons concerned, free from overreaching and consistent with the Act's purposes. 15 U.S.C. § 80a-17(b). It is under these provisions that the SEC exemption in the instant case was granted.[131]

The gist of plaintiffs' 10b-5 fairness arguments is that Christiana and its shareholders are, notwithstanding the fiduciary obligations stemming from their control position, improperly profiting at the expense of Du Pont because the market value of Christiana's shares was not utilized in developing the exchange ratio.[132] Viewed from another perspective, plaintiffs are simply attacking the use of Christiana's net asset value since that figure was substantially higher than the market value of Christiana common. In so arguing plaintiffs have overlooked the Investment Company Act of 1940.

The 1940 Act, as detailed above, was designed to protect shareholders of investment companies. One mode of guarding those shareholders' interests was to create various restrictions and prohibitions designed to protect their intrinsic investment in a company's net assets. Thus, for example, the Act erected stringent restrictions on the issuance of senior debt or securities by requiring asset coverage of 200% or 300% respectively for any senior stock or debt securities issued. 15 U.S.C. § 80a-18(a)(1) and (2). The obvious purpose behind these restrictions was to protect common shareholders against dilution of their intrinsic investment value through a highly leveraged capital struc-

[130] See note 8, *supra.*

[131] The correctness of the issuance of that exemption is not before this Court. Instead that question is presently before the Circuit Court of Appeals for the Eighth Circuit.

[132] Complaint, ¶ 11 at 14.

ture, 15 U.S.C. § 80a-1(b)(7), which, in a falling market, could dissipate their investment through a corresponding decline in the market value of the company's securities portfolio. This in turn would leave, after accounting for the prior entitlements of the senior securities, a highly eroded net asset value for the common shareholders. In addition, the Act raised an additional obstacle to highly leveraged capital structures by requiring dividend restrictions in companies with senior debt or stock to preclude avoidance of the aforementioned asset coverage standards. 15 U.S.C. §§ 80a-18(a)(1)(B)[133] and 80a-18(a)(2)(B).

The Act also made net asset value, based upon the market prices of an investment company's portfolio securities, the fundamental valuation criterion of registered investment companies. 15 U.S.C. § 80a-2(a)(41). *Central States Electric Corporation,* 30 S.E.C. 680, 700 (1949). Moreover, despite the fact that the closed-end discount phenomenon was well known in 1940, *Christiana Securities Company, supra* at 23, n.57, Congress decided to prevent dilution of closed-end stockholders' intrinsic values by preventing the issuance of any new common stock "at a price below the current net asset value of such stock." 15 U.S.C. § 80a-23(b).

The Securities Exchange Commission, the agency authorized by Congress to implement the 1940 Act and pass upon otherwise prohibited transactions between investment companies and their affiliates pursuant to section 17(b), 15 U.S.C. § 80a-17(b), has consistently utilized net asset value as the controlling factor in section 17 proceedings. *See, e.g., Central States Electric Corporation,* 30 S.E.C. 680, 700, 724-5. This has been true notwithstanding

[133] While section 18 is not directly involved in the present case, nor is Christiana a highly leveraged investment company, reference to the provisions of section 18 have been made as additional illustrations of the rigorous restrictions applied by Congress to protect shareholders of regulated investment companies.

the fact that the market value of the applicant investment company's stock was significantly lower than its net asset value. *See, e.g., Delaware Realty & Investment Company,* 40 S.E.C. 469 (1961); *Harbor Plywood Corporation,* 40 S.E.C. 1002, 1010 (1962); *Detroit and Clevland Navigation Company,* ICA Rel. Nos. 3082 and 3099 (July 27, 1960 and August 19, 1960); *Townsend Corporation of America,* ICA Rel. No. 4045 (Sept. 2, 1964), CCH *Fed. Sec. L. Rptr.* ¶ 77,120. Net asset value has also been utilized where no market existed for the common stock of an applicant investment company. *Eastern States Corporation,* ICA Rel. No. 5693 (May 28, 1969); *Huyler's,* ICA Rel. Nos. 5773 and 5809 (August 13, 1969 and Sept. 9, 1969); *Southport Commercial Corporation,* ICA Rel. Nos. 4165 and 4180 (Feb. 17, 1975 and March 5, 1965).

Courts are obliged to accord great deference to an administrative agency's construction of the statute it administers. *See, Lucas Coal Company* v. *Interior Board of Mine Operations Appeals,* No. 74-1813 (3d Cir. Aug. 29, 1975). Plaintiffs have been unable to demonstrate any appropriate reason why net asset value should be discarded, the SEC's teachings disregarded, and Congress' mandate ignored in the instant case. The use of net asset value as a valuation device for investment companies stems from the long-term investment characteristics of such entities. *See Christiana Securities Company, supra* at 23, n.57. Since the bulk of Christiana stock has been held by long-term investors there is simply nothing that suggests the inapplicability of net asset value in development of the merger ratio. Further, were net asset value to be cast aside and market value utilized as a significant factor in calculating the instant exchange ratio, the resultant gain to Du Pont's shareholders would improperly deprive Christiana's stockholders of a substantial portion of the intrinsic values of their holdings. *See Id.* at 24.

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